Overview of Remittances

The purpose of this document is to provide an overview of global remittance flows and activities that have been undertaken by the donor community to increase the development impact of this resource. Many of the examples noted below are USAID projects, some of which are public-private alliances supported by GDA.

Much of the pioneering work in this area has been done in Latin America due to the fact that large diaspora communities living in the U.S. are sending a greater volume of funds back to their home countries. However, there is increasing interest in other regions as well. There are a range of activities that have been undertaken on remittances to date that could be relevant for programmatic considerations in countries where USAID operates.

I. What Are Remittances?

Remittances are the money that foreign born workers send to their relatives and/or communities back home. The volume of global remittance flows is difficult to estimate since many countries have inadequate processes by which to report on funds sent back by foreign workers. The World Bank estimate that remittance flows totaled $93 billion in 2003, exceeding ODA ($58 bn) and net debt flows ($44 bn). While many believe this underestimates actual flows, other experts feel it is an overstatement with one USAID expert calculating them to be in the range of $20 billion annually.

Regardless of the amount, there is widespread agreement that the volume of such flows is increasing on an annual basis. In many countries, remittance flows exceed FDI and represent increasingly large percentages of GDP. The U.S. is the largest source country, with $31 billion of remittance outflows annually, followed by Saudi Arabia with $15 billion. Remittance volume is not surprisingly greater to large countries, with Mexico, India and the Philippines the top three recipients in terms of volume in 2003. However, remittances represent a larger portion of GDP to small countries, with Tonga, Lesotho and Jordan as the top three recipients in percentage of GDP terms for 2003. Globally, remittances represent 2.9% of the GDP of low-income countries.

II. Why Are Remittances Important?

Remittances are becoming an increasingly important resource for developing countries, and are receiving greater attention from development experts. Remittances have been perceived negatively in the past because their primary use is for consumption. However, this has changed in light of increasing evidence that remittances can promote poverty alleviation, economic growth, increased investment and community development.

Remittance flows can have both positive and negative consequences that should be taken into consideration. On the downside, increased hard currency flows can result in exchange rate appreciation, inflation, and higher interest rates, creating what is termed

"Dutch disease" and deterring investment. These flows can also create dependency and raise inequality in recipient countries.

On the positive side, such flows are stable, create no liability as is the case with debt, increase both consumption and investment, and are often used for health care and education, thus having a direct development impact on the recipient. Furthermore, encouraging the use of formal channels for remittances can create a source of capital for investment activities, which can lower the cost of capital and increase the savings rate in a country.

Beyond direct person-to-person transfers, there are other important ways that diaspora's remittances can support development objectives. These include increased FDI, technology transfer, and enhanced trade relations. Diaspora communities have engaged in creating business networks, supporting investment promotion efforts, directly funding infrastructure projects, and providing training and voluntary consultancies. These have direct implications for income and job creation activities.

III. What has the Donor Community Done on Remittances?

The following summarizes broad categories of activities that have been undertaken with respect to remittances. This is not meant to be an exhaustive list, but rather to encourage thinking on potential programs.

A. Reducing Transaction Costs

The general objective of most donor activities is to lower transaction costs for remittances. During the recent G8 summit, leaders called for reducing the transaction fee for remittances by half by 2008. The January 2004 Summit of the Americas also called for a similar goal for transfers to the LAC region. Efforts to lower the transaction costs have included the following.

- *Working with Credit Unions to Handle Transfers.* Many of the more successful efforts to reduce the costs of remittances involve the development of local credit unions to handle the transactions. The World Council of Credit Unions (WOCCU) has been particularly active in Latin America in working with local credit unions to provide a money transfer mechanism at a much lower cost.

  Public-Private Alliances: USAID has supported WOCCU in developing the Caja Popular Mexicana program. USAID has also supported WOCCU's International Remittance Network (IRNet), which has facilitated transfers through credit unions in six Latin American countries.

- *Policy reforms to increase competition in the sector.* Any activity to promote liberalization of financial services has the potential to lower transaction costs through increased competition. This can involve taking Post Office Service Banks (POSBs) out of their monopoly position, increasing the number of commercial banks, or creating microfinance and credit union entities. By generating greater competition, such efforts produce lower costs.

- *Reforms to allow for disbursements in hard currency*. Many Central Banks, particularly those in the E&E region, do not allow funds to be disbursed in foreign currency, thereby requiring that the inflow of dollars be converted to local currency at official rates. In countries where there is a great differential between official and commercial exchange rates, this can significantly increase the cost for the transfer.

B. Introducing New Technologies

- *Supporting new technologies*. The introduction of new technologies, particularly debit cards and other electronic transfer platforms, provides a fast and secure method for money transfers and can also lower the cost of transactions.

  Public-Private Alliances: USAID has supported FINCA and Visa in developing technology to create debit accounts at rural banks in Nicaragua, El Salvador and Guatemala. This activity has the potential to increase secure remittance transfers to all countries, but specifically emphasizes reducing the costs of remittances to El Salvador. A similar initiative by HP, FINCA and other partners in Uganda allows for financial transactions in rural areas through Remote Transaction Systems (RTS), which also reduces the cost of remittance flows.

- *Expanding the Base of Existing Technologies.* Financial services firms and non-profit organizations are entering the money transfer business on a regular basis, which creates opportunities to identify partners that can handle remittance transfers at a lower cost. For commercial banks, this has marketing potential for expanding their customer base. Web-based entities are also springing up that are often focused on specific countries.

  Public-Private Alliances: USAID has supported the creation of GlobalGiving, a website that allows individual donors to make contributions to specific international projects via a secure mechanism with a low transfer cost. This can be expanded to include additional projects and countries.

C. Establishing New Institutions

- *Support a microfinance institution.* Establishing a microfinance institution to handle remittances can increase access to these flows, particularly in rural areas. In addition to providing a formal channel that would potentially have a lower transaction fee, the creation of these institutions has the additional benefit of "banking the unbanked" by offering broader savings and investment opportunities. Recipients could use remittance flows to open a savings account or purchase a CD to generate interest income, or as collateral for mortgages and small business loans.

Public-Private Alliance: The FINCA/VISA effort in Central America and FINCA/HP project in Uganda noted above both include development of microfinance institutions to serve rural areas. These activities provide electronic platforms for deposits and withdrawals that reduces the operational costs for microfinance institutions.

C. Education

- *Educating Banks and Consumers on Remittances.* Educating banks on the benefits of offering remittance services on a competitive basis can increase the overall level of remittance flows and reduce costs. Educating the local population on how to use these services would generate demand and potentially attract new customers, thus creating a win-win for both the bank and the consumer.

  Education Efforts. The FDIC has hosted a Festival of Finances in some U.S. cities to educate local migrant populations on the benefits of opening local bank accounts. This both increases local populations' access to financial services and can also provide a more secure and cheaper way to send remittances. The FDIC also has literature available on other financial services activities.

D. Supporting Development Activities

- *Developing a Mechanism to Assist Community Based Projects.* The most interesting and perhaps most challenging activity related to remittance initiatives involves groups of migrants pooling their funds to institute community based projects in their home areas. One type of activity involves assisting U.S.-based organizations or hometown associations (HTAs) of migrant communities in supporting projects in their home countries. These donations could be matched on a cost-share basis from USAID, community organizations, and larger diaspora groups. Such projects can involve specific activities, such as building schools and clinics, as well as training local associations in managing projects.

  Public-Private Alliance: USAID has supported the Pan American Development Foundation (PADF) in pooling remittance resources for HTA projects in Haiti, Mexico and El Salvador. This has resulted in such activities as building schools, funding scholarships and improving roads and sanitation.

- *Creating Development Funds with Remittance Transfer Companies.* Creating development funds from remittances involves the support of the transfer company. In such cases, the MTO or transferring entity donates a portion of their transfer fee to a community development fund. The company can then market this activity to demonstrate their commitment to invest in the recipient country, thereby creating a competitive advantage that can be used to increase their customer base.

Public-Private Alliance: In Haiti and El Salvador, USAID and PADF worked with Unitransfer to secure donations of a portion of the transfer fees to a development fund. The IAF has initiated similar efforts with remittance companies in Jamaica and the Dominican Republic.

- *Responding to Disaster Situations.* In the aftermath of humanitarian disasters, large resource flows are often generated by private contributions that may or may not come from diaspora communities. In these cases, the existence of a mechanism to pool such resources could allow for larger community rebuilding projects. Thus, a formal mechanism could be used to enhance the development impact of such flows.

  Public-Private Alliance: There is increasing interest in creating country specific portals via GlobalGiving in response to disasters. A pending project would focus on activities in support of Haiti's rebuilding efforts.

- *Creating a Form of Collateral*. Remittances have also been used as a form of collateral for loan securitization and bond issues. These activities are structured similar to securitization of future oil revenues to raise finance.

- *Examples:* In 2001, Banco de Brasil completed a $300 million bond issue securitized with future Yen remittance flows from Brazilian workers in Japan. The bond rating was significantly better than the country's sovereign debt rating. El Salvador, Mexico, Panama and Turkey have also used remittance-backed flows to secure financing. In addition, the Armenian diaspora community created an SME Investment Fund sponsored by the IFC.

IV. What Resources are Available?

- A USAID Working Group on remittances includes Kate McGee, Jolyne Sanjak, Chris Baltrop, Barry Lennon, and Evelyn Stark. Contact Evelyn Stark for the group's newsletter and other documents.

- An internal USAID weboard on remittances is now being transferred to www.microlinks.org and can soon be accessed by USAID employees. This site will have information on remittances in the Community Practice section. This will include internal USAID talking points and research on the subject.

- The Armenia Mission has prepared a Statement of Work (SOW) for a consultant to prepare an assessment of remittance flows to that country in order to examine what can be done to improve their reach. The GDA office can provide a copy of that language to anyone interested.

- Two recent reports can also be obtained from the GDA office. USAID commissioned a study by the Carana Group entitled "Diasporas, Emigres and Development" that addresses the issues outlined above in greater detail. The

Inter-American Dialogue Task Force on Remittances recently issued a report entitled "All in the Family" that focuses on Latin America.